RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Sept. 15, 1993 **LETTER 1130**

THE PICTURE: I got some needed rest following my bout with a mild heart attack. But I think the thing that rested me most was the knowledge that Bill Clinton was on vacation (he was hanging out with Jackie O. and the Kennedy gang at Martha's Vineyard). At the same time, happily, Congress was out of session. With both the Prez and Congress away from Washington, what evil could befall the American public? It was a restful week.

Now comes the news that Al Gore is going to "re-invent" government. Never mind re-inventing it Al, just get rid of a lot of it. There's nothing in Al's program about actually closing down departments or actually passing out pink slips (the job losses will result in attrition not firing). But what really disappointed me was that there was not a word about the incredibly inefficient, insufferable tax system. Gore, if you really want to re-invent something, re-invent the tax system and give us a flat tax or a national sales tax. But maybe that's too hot to handle (because it would take too much power away from the politicians).

Meanwhile, Fed Chairman Greenspan (remember, the Fed is still pumping wildly) states that the money supply figures don't work any more, but instead he's keeping an eye on other things like real interest rates and gold. And gee, he even says he's worried about inflation. Greenspan warns that the Fed may have to raise rates, but you know that's just idle talk. What the Fed is really fretting about is those billions of dollars a day that are pouring into the overpriced stock and bond markets. Obviously, Greenspan is worried about the stock and bond markets topping out -- so what he's trying to do is gently put the brakes on Wall Street. Be careful, Alan, you may get what you wished for.

DOW THEORY: Thirty-five years ago I started this publication, and I named it Dow Theory Letters. I've never changed the name. That being the case, let's talk a little Dow Theory. You may not have noticed it but back on April 16 the D-J Transportation Average recorded a record high of **1683.08.** I've kept an eye on that number. And do you know -- despite numerous new record highs in the D-J Industrial Average, **1683.08** has not been bettered.

In other words, five months have passed without a confirmation by the Transportation Average. From a Dow Theory standpoint, when an over-valued, over-extended stock market continues to rise, and at the same time, when an important but little-noticed non-confirmation is in place -- well, that's not a good sign. And when it occurs with record low stock yields, that's darn sure not a good sign. Could a primary bear market be starting? Too early to tell, but here's a confession -- I'm not waiting. I'm about out of common stocks.

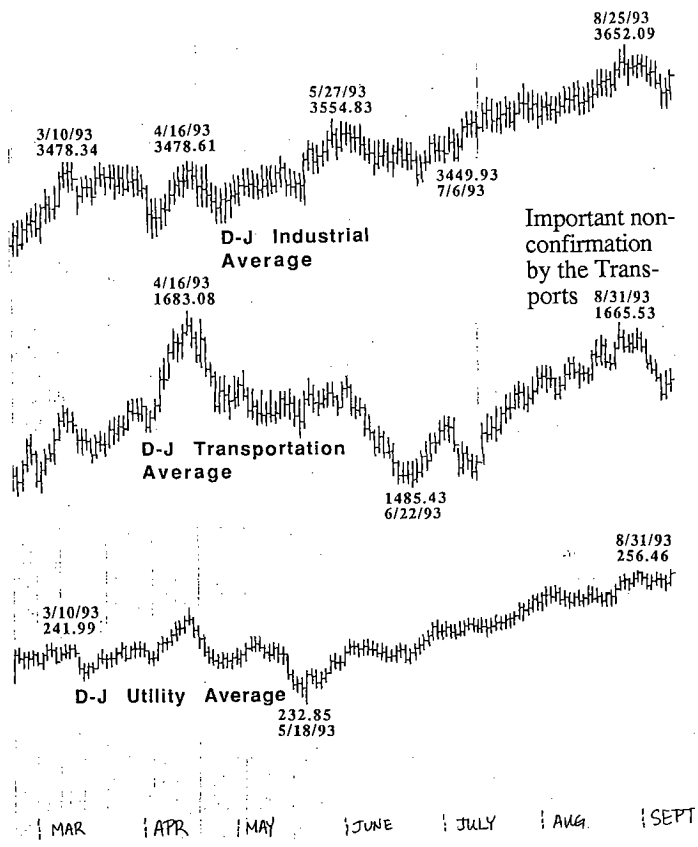
Note: Speaking of the Transports, in the magazine section of the Sunday *NY Times* (Sept. 6), there's a shocking article about American Airlines. The article quotes American Airlines' CEO as saying that the way things are going (meaning continuing losses), AMR (the holding company for American Airlines) may get out of the airline industry altogether. The fact is that the big airlines are, and have been, losing billions of dollars, and they are being chewed up by smaller, low-overhead, start-up carriers. The article was a shocker, at least to me it was.

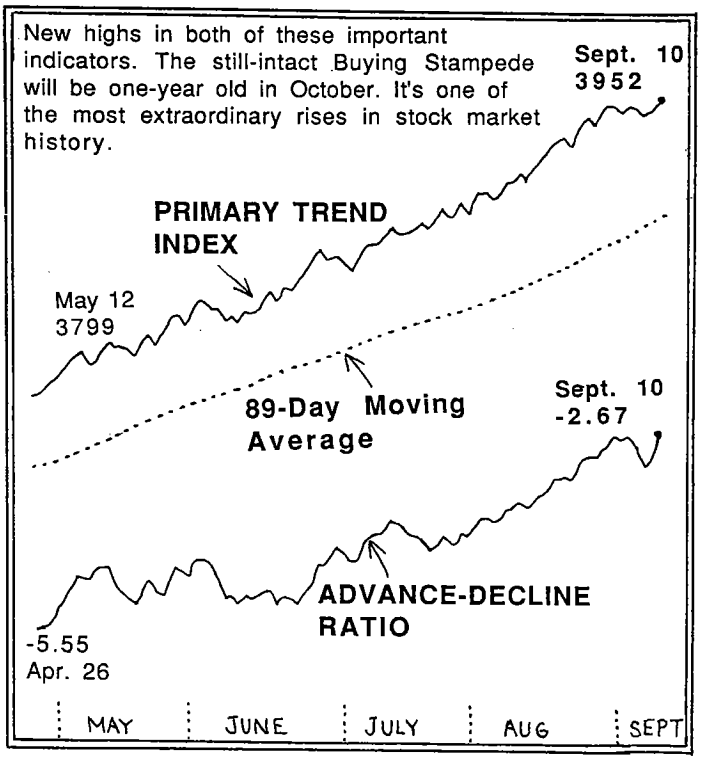
Question: The D-J Utility Average has been making new highs. Generally (but not always) the Utility Average tends to turn down well before any broad market trouble. This is also true of bonds. So why would anyone look for trouble with the bonds at new highs (with accompanying new lows in interest rates) and while the Utilities are also just off their highs?

Sept. 2 DJIA 3626.10; PTI 3942; A-D Ratio -2.59
Sept. 10 DJIA 3621.63; PTI 3952; A-D Ratio -2.67
Dow Yield: 2.81%; Dow Price/Earnings: 43.7
Dow 200-day MA: 3438; Dow 30-day MA: 3596
Dow Times Book Value: 2.78; PTI 89-day MA: 3873
Percentage of Undervalued Blue-chips: 6%
Low Risk Buy Index: +71

Answer: The best-known, most-widely publicized action today is that the 30-year Treasury bonds have risen to all-time highs and that the yield on these bonds has dropped below 6%. Furthermore, it is well known that the Fed wants interest rates to stay low, low, low. Finally, it's obvious that President Clinton has been having a love affair with the bond market. In fact, hardly a speech goes by when Clinton doesn't say something nice about those low interest rates and the bond market.

It reminds me of that old stock market adage which states, *"When everybody's thinking the same way -- nobody's thinking."* I get the feeling that this adage pretty much applies to the stock and bond markets today. Everybody is aware that the stock market has been trading off low interest rates plus exploding liquidity (compliments of the Fed), and it is generally conceded, therefore, that nothing "bad" can happen to the stock market as long as this is the case. It's the prevailing wisdom. And the prevailing wisdom is becoming suspect.





BATTLE: There's a battle taking place on Wall Street (actually, there's always a battle). It's a battle of low interest rates and liquidity vs. a recession-prone economy. Which one will be the winner? Can't tell yet, but I think we'll know fairly soon.

However, we do know a few things about this economy. We know that the massive liquidity that has been generated by the Fed has not been sifting into the economy. It hasn't been going into new plants and equipment, and it hasn't been going into industrial and commercial loans. No, the Fed-generated liquidity has been going into the stock and bond markets. The Fed has been fomenting inflation all right, but it's INFLATION IN THE FINANCIAL MARKETS. It's inflation that has driven the stock and bond markets to record highs. But amazingly, the inflation in the markets has not, so far, rubbed off on the US economy.

Why have the Fed's re-inflation efforts all funneled into the financial area? Why haven't these low, low interest rates and all this pumping fired up business? Is it simply the power of the down-trending Long Wave (the Kondratieff Wave)? Is it fear of what our socialist-leaning President will do next? Is it the inability of a debt-choked economy to revive itself? We just don't know, not yet we don't.

But what we do know is that eight out of 10 small businessmen oppose Clintonomics. We know that the Small Business Confidence Index has come down every month since January. We know that "Consumer Expectations" have declined drastically from 83% in January to 65% in July. We know that retail sales in August were weak, dampening hopes for sales during the rest of the year (including Christmas). We know that new orders for Durable Goods have dropped in four out of the last five months. We know that the new taxes imposed by Clinton are hated by the wealthiest and most productive sector of society. We know that Clinton is dedicated to reversing every nuance of the Reagan '80s. We also know that the "Nightmare of the Nineties" has materialized. What is it? The Nightmare of the Nineties is unemployment, chronic, unending unemployment.

Question: Let's stop the gobbledy-gook. Is the US in recession? My personal opinion -- we never got out of recession. The recession of '91 eased up some, due to massive Fed infusions of liquidity. Furthermore, recession sentiment was covered up some by the rise in the stock and bond markets. But from a businessman's standpoint I don't think we ever got out of the recession of '91. And by the first quarter of next year, I wouldn't be surprised to see corporate profits heading down again, and the world "recession" being generally accepted.

By the way, *Fortune* magazine (and the *Fortune* people tend to be perma-bulls) has a most edifying article in its Sept. 20 edition. The article is entitled, "When Will the Layoffs End?" The subtitle is "Not soon, maybe never. For many large companies in the Nineties, the big shrink has become not a one-time event but a way of life." The article continues, "The layoffs of 255,000 employees announced in the first half of 1993 represent a third over layoffs for the same period of recession-plagued '91 . . . The big shrink at big manufacturers and service companies has less to do with tepid economic recovery in the US . . . than with structural changes. The new mindset among job-cutting companies is that the world economy faces a sustained period of slow, low inflationary expansion and global overcapacity, an era in which they cannot easily raise prices to expand profit margins . . . One can already spot more layoffs on the way. The Bureau of Labor Statistics forecasts that scheduled cuts in defense spending will result in over 300,000 fewer jobs at major military contractors -- and nearly a million more positions lost at their suppliers -- through 1997. Troubled airlines -- big job shedders of late -- are canceling orders or stretching out delivery of new aircraft, foreshadowing likely employment cuts at Boeing and McDonnell Douglas."

Russell comment: A columnist stated, "If you like being fired, this is a great time to be in America." In today's globally competitive climate, it's extremely difficult to raise prices. But to boost or even hold on to profits, almost every industry continues to layoff workers, both blue collar and white collar. This painful process is a plus for industry's bottom line but a minus for the economy. The battle for profit-survival continues unabated.

All right, enough economics,-- back to the stock market. Question: Are there any immutable laws that can be applied to the stock market?

Answer: I think so. One is that, "What goes down eventually goes up." And then there's it's well-known corollary, "What goes up eventually comes down." The only thing we don't know is how far "it" goes up, and after going up, how far "it" will come down.

Dow Theory puts it a bit more succinctly. Dow Theory says, "All movements, whether primary, secondary or minor, will ultimately be corrected."

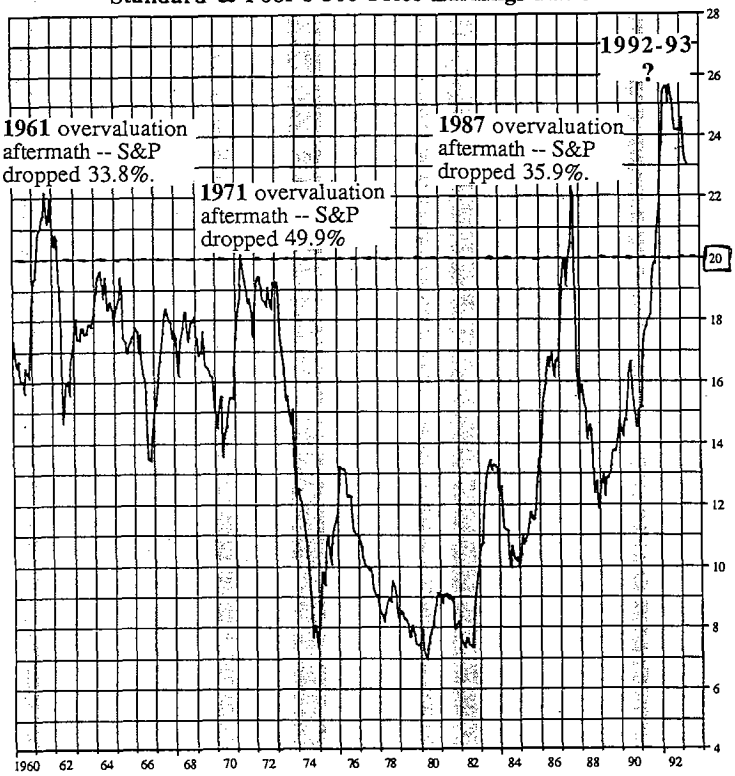
Here's another "law" of the markets, or should I call it an observation. It tells us that when any category -- stocks, bonds, soy beans, copper -- gets too expensive, then informed investors (i.e., those who know values) start selling. When the selling becomes insistent and powerful enough, the item declines in price. The corollary here, of course, is just the opposite: when any item sinks into the bargain basement area, informed investors start accumulating the item. When sufficient accumulation takes place, a new bull movement is born.

Question: When can we say that the stock market is overvalued? The fact is that there definitely are specific measurements of under and overvaluation, measurements that have withstood the test of time. Despite this, there are always those analysts who come up with reasons why this time the time-honored gauges of valuation are not valid. I call this the "this time it's different" argument.

As I stated earlier, the main argument "this time" as to why the market is not overvalued and why it's going higher is that interest rates are extremely low and "today the stock market is trading off interest rates and liquidity, courtesy of the Fed".

One market skeptic is Dr. Kurt Richebacher, former chief analyst for the Dresdner Bank and now publisher of *"Currencies and Credit Markets"* (FAX -- 4316 957 0602). In his latest report the good Doctor writes, *"Just as the Fed's easing is the most aggressive on record, the inflation in the stock market exceeds that of 1927-29, too. The P/E ratio for the Industrial stocks in early*

Standard & Poor's 500 Price Earnings Ratio



1929 hit a high of 16.2. Just before the crash the P/E was 13.5. Presently, the average P/E ratio for the Dow is a lofty 32 (Russell note: it's now 44). The S&P multiple is currently much higher than 1929, too; so are the fundamentals. In the 1920s the US had much higher savings and the Federal budget was in surplus. Today, stocks are soaring on the back of an abysmal savings ratio and record-high budget deficits."

What about those multiples that Dr. Richebacher refers to? To illustrate the P/E situation, I have included a chart (page 3) of the S&P 500 price/earnings ratio. The chart goes back to 1960 so this provides us with some historical perspective.

Only three times since 1960 has the P/E for the S&P been above 20. The aftermath of each such period of high P/E ratio (i.e., overvaluation) was a market smash.

Currently, the P/E for the S&P 500 is at 23.79. Thus, we are now in a good position to see whether history will repeat here in 1993 or possibly as late as 1994. At any rate, it's my opinion, based on both the P/E ratios and the current minuscule dividend yield, that this market is severely and chronically overvalued. The market is also turning a bit ragged with many good stocks being severely battered.

I've never been a believer in the "internal correction" thesis, the thesis which states that when a goodly number of selected stocks have taken a beating, even though the major stock averages have held up, that action serves as sufficient correction for the market. It just doesn't work that way. A true market correction always shows up in the market averages.

My feeling is that the great bull market may be nearing its end. Consider this -- in 1993 money has been coming into this market (into equity mutual funds alone) at the rate of around $10 billion a month. Yet in the face of these enormous amounts the stock market has not done a heck of a lot.

One reason, of course, is that an equally enormous amount of new stock has been issued. New equity financing in July alone was $8.24 billion, which brings the 1993 total so far (the first seven months) to $55.7 billion. This is an all-time record.

On top of that, margin debt in July rose by another $260 million to a record total of $49.81 billion, up more than a third since January 1992. That's an awful lot of stock on margin. And with that kind of fantastic leverage you'd think that the market might have done a lot better than it has.

Bernard Baruch, the great financier of the 1920s and '30s claimed that he got rich by "selling too soon." Baruch was no fool. He was one of the few real heroes of the Depression. Baruch came out of the great crash of '29 with most of his assets still intact (not all, but most), and as a result market historians still write about him with respect if not awe.

My PTI hit its last high (see page 2 chart) on Sept. 10, and that action was confirmed by the advance-decline ratio. Incredibly, the latter has been in a Buying Stampede phase for the past 11 months. To my knowledge, this is the longest (in duration) Buying Stampede in stock market history.

For new subscribers, my definition of a Buying Stampede (and Stampedes are rare) is a situation where the A-D ratio rises five points or more without an intervening correction of one point or more.

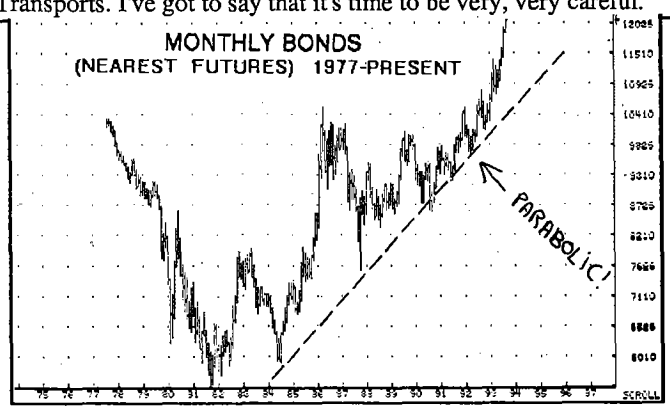
The A-D ratio turned up from a low of -10.91 last October 9. The latest figure for the A-D ratio is -2.67, which means that the Buying Stampede has, so far, added 8.24 points to the A-D ratio. This is far from a record. By that I mean that although the A-D ratio has been rising for 11 months, its upside progress (in points) has not been impressive.

The fact is that there have been Buying Stampedes in the past that have added double that amount in half the time. Example: in the 1982 Buying Stampede, between August and November, the A-D ratio rose by 10 points. Again between December 1942 and July 1943 a phenomenal Buying Stampede took the A-D ratio up 21 points. So I have to say that the action of the market since last October contained an awful lot of "churning." An 11 month Stampede that's moved the A-D ratio up only 8.2 points -- amazing.

There you have it -- an 11-month Buying Stampede, major non-confirmation in the Averages, a parabolic rise in the bonds, the public buying stocks and bonds hand over fist, record low yields on both stocks and bonds. I'd say it calls for caution, wouldn't you? The bulls can say that the odds are always against a catastrophe. And they're right. I just don't like the odds today.

INVESTMENT POSITION: The bull is still in the box, but he's an extremely nervous bull. I can't advise my subscribers to join in with the masses who are throwing their hard-earned bucks, willy-nilly into the markets (largely via mutual funds). Did you know that you can now buy funds through Wells Fargo's automatic teller machines (ATMs)? What's next, selling funds from street-corner vendors?

The bonds have gone parabolic (Alan Greenspan, take notice) and we have a major non-confirmation between the Dow and the Transports. I've got to say that it's time to be very, very careful.



I've had five dozen people ask me what happens to gold shares if the stock market falls out of bed. My opinion, they'll resist the decline, and if a downturn in the market turns out to be the start of a bear market, I believe gold shares would move up against the prevailing market trend.

By the way, in case you haven't thought about it, a bear market here would be an unmitigated disaster. A bear market would obviously be very deflationary, and with $15.2 trillion in total US debt outstanding, deflation would raise serious doubts about the viability of an awful lot of this debt. That in turn would put major pressure on the dollar (and probably on ALL currencies). My advice -- careful, careful, careful.

NOTES & QUOTES: I think I've heard most of the rumors, good and bad, about the Clinton tax boosts. One fascinating one is that the "big bankers" (i.e., big Republican money) WANTED the Clinton program, a program which is obviously anti-business and deflationary. Why? So that the Fed would be forced to lower and lower and lower again interest rates (in order to keep the economy from tanking). The lower rates have made billions for the banks and for the big bond holders and speculators. The whole thing sounds plausible to me. You know, I'll believe anything these days, particularly if it concerns Washington.

* *

This from *Peter L. Bernstein, Inc.* (575 Madison Ave, NYC 10022): *"The President, according to rumor, is madly in love with the long-term bond market . . . The President seems to have forgotten that investors in the bond market are killjoys. They love bad business news. If interest rates are falling, the chances are that the rate of unemployment is sticky and production is sluggish -- at best. Anybody who thinks that falling interest rates are good news has forgotten exactly what kind of good news they were looking for in the first place."*

* *

What's this? Malcolm Forbes Jr. in the latest issue of *Forbes* has come out for a flat tax of 19% across the board. I've been advocating the same thing for years -- get rid of the current abominable, unfathomable, corrupting US tax system and replace it with either a flat tax or a national sales tax. It would be the biggest boon for this nation since the advent of the computer. Forbes says the Republicans should grab this idea "for their own, lest distraught Democrats embrace it as they desperately distance themselves from their unpopular President." I agree -- 1,000 per cent. A flat tax or a national sales tax -- an idea whose time has come.

* *

The good folks at *Market Logic* [(800)442-9000] included a fine study of dividend yields (matched against all levels of interest rates) and concluded,*"There is no substitute for measuring corporate prosperity in terms of cold cash payments to stockholders. The dividend yield indicator is the single best long-term market forecasting indicator. Its current low reading bodes ill for market returns through the 1990s."*

Russell comment: Right now the yield on the Dow is a low, low 2.85%, which means that historically we're in the danger area -- and this regardless of prevailing interest rates. Furthermore, the Dow now earns $82.78, but it's paying out $101.92 in dividends. This means that either earnings must boom or we will see more dividend cuts.

* *

How are things in the good old Golden State? Well, here in Southern California we've seen better times, as this recent headline from a local paper suggests.

County jobless rate: 9.2%

July figure is highest since 1986 as the labor force grows

By RICK SHAUGHNESSY
Staff Writer

The San Diego County unemployment rate soared to 9.2 percent in July, its highest level since at least 1986, as a traditional summer wave of new entrants to the labor force had only moderate success finding work.

The increase in the jobless rate the national average — in April to a rate nearly as high as the statewide average in July.

The state Employment Development Department reported yesterday that more than 112,000 county residents were unemployed and seeking work in July.

"It is certainly an indication that San Diego's economy is still experi-

Greater San Diego Chamber of Commerce.

"There is no quick recovery seen on the horizon. We seem to be making some progress in some areas and not in others. . . . The unemployment figures continue to be troublesome."

The 9.2 percent jobless rate is the high-

current form.

It compares to an 8.4 percent jobless rate for June, and a 7.4 percent rate for July 1992.

California, which has one of the nation's highest unemployment rates, saw its jobless level climb from 9.1 percent in June to 9.8 percent in July, the highest level

* *

Speaking of unemployment, these are the global unemployment rates as listed in the *Economist*. Nine of the 13 countries have unemployment rates above 8% and six have rates above 10%. And if these nations are phoneying up their unemployment figures the way our government does here in the USA, you can bet the rates are even higher than those posted on this list.

	unemployment % rate	
	latest	year ago
Australia	10.7 Jul	11.0
Belgium	9.5 Jun	8.2
Canada	11.6 Jul	11.6
France	11.6 Jun	10.2
Germany††	8.3 Jul	6.7
Holland	5.0 Jul‡‡	3.8
Italy	10.8 Jun	10.3
Japan	2.5 Jun	2.1
Spain	16.4 Jul*	14.1
Sweden	9.6 Jul*	5.3
Switzerland	4.6 Jul*	2.5
UK	10.4 Jul	9.8
USA	6.8 Jul	7.6

* *

The men and women who write market letters tend to be rather secretive about their operations. Personally, I dislike secrets. The only "secret" I have is the composition of my PTI. Everything else is open. At present I have just under 7,000 subscribers, which is about the most I've ever had. I figure, what with copying (thank you, Xerox) and sharing and looking-over-shoulders, about 25,000 people (probably more) read these letters. When you have that many people reading your stuff and writing to you occasionally, well, you tend to get interesting feed-back.

Last week I received a letter from a long-time subscriber, an Indian (from India), and a member of the Gandhi family. And well, if you believe in psychics (and especially Indian psychics) here's what the letter said: *"Respected Sir, A holy man, a Guru from India, recently gave the following revelations. This psychic claims the following future for America to come true within two years!! Future in August, 1995.*
(1) Inflation, more than 15%.
(2) Unemployment, more than 15%.
(3) US dollar, very weak!
(4) Higher prices for gold -- actually a gold fever on! European currencies very respected, D-mark, Swiss franc.
(5) Violence in the US, Europe particularly German bloc, much better to live in than US. Gratefully, Gandhi."
Russell comment: There you are, you heard it first here.

* *

Germany is now an interesting study. Some say the German economy has hit bottom, others say that Germany is heading into a depression. I have no firm opinion on this. But it is notable that in a recent study the German Motor Industry Federation found that the total cost of a German car worker at DM47 per hour was two-thirds higher than the rest of Europe and more than a third higher than either the US or Japan. Something has to give. And it is. On August 24 Mercedes-Benz announced plans to cut 14,000 jobs next year -- on top of more than 20,000 jobs cut this year. Check this: in 1970 VW sold 560,000 cars in the US. Last year it sold just 82,600. Is VW going to survive?

* *

As for Japan, Toyota will announce the first annual loss in its history. And Honda announces that it will hold '93 prices on its Acura. Russell comment: How long will it be before China starts selling cars to the world? The fact is that the world now produces too many cars. Competition up to now has been rough. It's moving into the "cut-throat" phase.

* *

What war can do for a country's currency: The national bank of Yugoslavia announced a week ago that it is issuing a one billion dinar banknote in order to keep up with skyrocketing inflation. The new banknote will be worth exactly three US dollars at the current exchange rate. Meaning that Yugoslavians holding dinars as savings are now broke.

* *

Don't miss "The Coming Reflation" article in the Sept. 13 issue of *Forbes* (a magazine that is getting better and better). Written by John Rutledge, the piece runs, "Looking further out . . . deflation is in its late stages. The next arbitration phase, reflation, is about two years away. It awaits a change in Fed governors, but if you

believe, as I do, that the Clinton Administration is concentrating on redistributing wealth, not creating it, you have to be concerned about the eventual return of inflation. The new higher tax rates will reduce investors' after-tax income from securities by more than 20%, drawing investors out of financial assets, pushing stock and bond prices down and interest rates and commodities up." Russell comment: I believe it, but it's going to take less than two years.

* *

A *Washington Post* article states that banks are losing their power and importance. There's a steady flow of money out of banks into the following: big corporate lending (such as GE), mortgages, real estate loans, college loans, auto loans, credit cards, installment in all these areas. And how about the money market loans, equipment leasing. The banks are losing out to mutual funds with full checking facilities. Since 1980 the banks have seen their share of the credit markets drop from 68% to the current 44%. In other words, banks now account for less than half the loans being made in the credit markets.

* *

FAMILY AFFAIR: Vincent Van Patten produces and stars with wife Betsy Russell in "The Break" for his Autumn Winds banner, with brother James as VP. And papa Dick Van Patten cameos as a washed-out tennis groupie called "Mr. Tennis." Of course the entire family's high strung on tennis, with Vince having made the circuit and beaten John McEnroe twice. But this movie is described as "the 'Bull Durham' of the tennis circuit." He tells the story of the "bush leagues," where they often play for $12-$15 a round, live in cheap motels in the heat of the summer, wash their own tennis clothes, etc. "Thank God I broke through," said Vinnie from Orlando, where they're shooting. Lee Katzin directs the movie, for which they raised $5 million. Martin Sheen, Valerie Perrine and Ben Jorgensen co-star

Betsy Russell, left, and Martin Sheen will join the cast of *The Break,* a tennis drama that will be filmed in St. Petersburg and Orlando.

Cameras will roll here for tennis film

Times Staff Writer

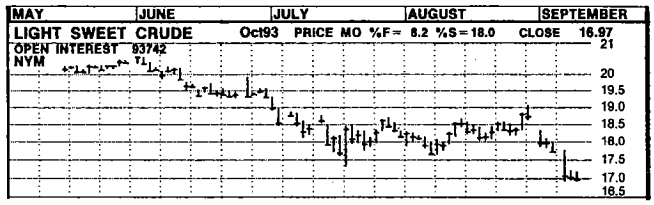
Former child actor turned tennis pro Vincent Van Patten is about to launch production on a tennis drama, *The Break,* which will film in St. Petersburg and Orlando.

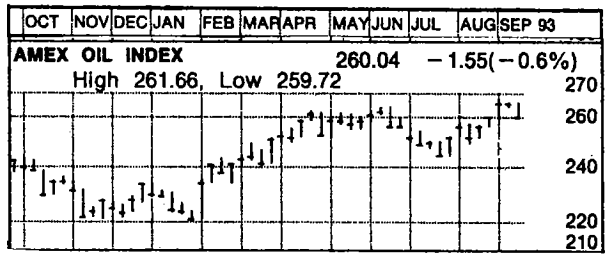
Van Patten co-wrote the TV movie and will star with Martin Sheen, Valerie Perrine, B...

Listen, a father is allowed to boast about his daughter and son-in-law, isn't he? At any rate, my thanks to Florida subscribers from the St. Petersburg area who were kind enough to send me this clip. The above paragraph is the way *Daily Variety* wrote it up.

You think the stock market or the commodity market is tough! Try writing, re-writing, casting and producing a movie -- and actually getting it made. You have to raise the money, and then sell, deal, sweat, and incidentally please a dozen people. To get a movie actually made is a major achievement, particularly if you do it as an independent (not with a studio). Last but definitely not least, you have to get distribution. It would be too much for me.

OBSERVATIONS: Are the rising markets (worldwide) preparing for something that is not yet obvious? It almost seems so. Take oil for instance. The actual commodity, oil, has been heading down, as the top chart clearly shows. Yet the stocks, on the whole, are doing well, with many oil stocks at or near highs. The lower chart of the AMEX Oil Index confirms the strength in the oil equities (charts courtesy of *Investor's Business Daily).*





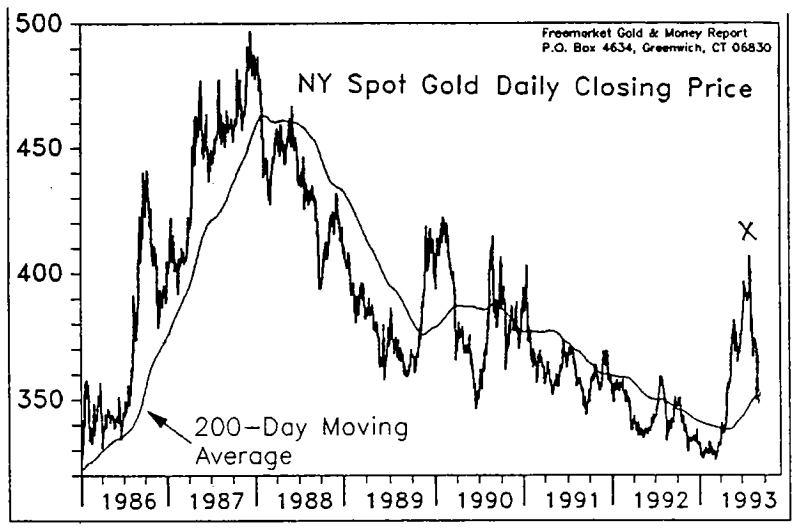
So what's going on? The oil stocks seem to be ignoring the current weakness in oil. And yes, they seem to be preparing for higher priced oil -- somewhere ahead.

With almost all the world's stock markets heading higher, despite lousy business conditions and deflationary symptoms everywhere, I have to wonder whether the world's stock markets aren't positioning themselves for ultimate inflation, big inflation.

As I argue in the Gold section, there's no way the debt-laden economies of the world can withstand real deflation. The cost of servicing all that debt (in a deflation) would create chaos. So, again, I wonder, are the world's stock markets saying the current stagnation and deflationary statistics are just the preamble to major inflation somewhere ahead. Don't bet against it. I repeat, the world has got to inflate. Let me put it another way, the stocks and bonds have already inflated -- are global economies next?

I want to take this paragraph to THANK the literally hundreds of people who sent cards and fruit and who wished me well. Also, I want to thank you for all the advice, pamphlets, booklets, etc. Surprisingly, I received many letters from physicians, and rather surprisingly many offered a great store of advice on "alternative medicine," including such items meditation, exercise, L-Carnitine, Coenzyme Q-10, G-Strophanthin, etc. I do take Coenzyme Q-10, which is the so-called "miracle nutrient" (CoQ10 is a vital catalyst in the creation of cellular energy), and it's widely accepted overseas. Again, I again want to thank all you well-wishers. Your thoughts, advice and prayers are MUCH APPRECIATED.

GOLD: Was this it? Was this the bitter end of what was widely announced by me and by gold-philes everywhere as "a new bull market in gold?" I can tell you what I think. But first let's refer to the accompanying weekly chart of gold along with its 200-day



moving average. The initial move off the 326 March low was what I call a "bullish impulse" move. It was powerful, it was persistent, it was explosive. And that advance did achieve one very important thing -- it took gold above the long downtrend line extending from the 1980 top (see chart in Letter 1121). In other words, the advance reversed a trendline that had held in force for 13 years. That's no mean feat. Technically, it was important.

But the upward explosion (intensified by the collapse of the ERM) from the March low was "too much too soon." A correction was in order. And corrections tend to be in proportion to their preceding bull advances. The correction from the 407 high has been just that. A "head-and-shoulders" top was formed. The right shoulder was weak, and breaking the support at 360 sent gold careening down to the 350 level.

Next, the relationship of gold to its 200-day moving average (MA). The MA comes in at around 350. There's nothing mysterious or sacred about a 200-day MA. But the 200-day MA does act as a marker, a level by which we can judge the power of a move (either up or down).

Now this is very important. Note (page 5 chart) how gold tends to group around (above and below) the MA. It will not travel too far above it nor too far below it. In other words, the MA acts as a magnet as far as the price action is concerned (chart courtesy of *Gold & Money Report,* PO Box 4634, Greenwich, CT 06830).

Note on the chart that at its July peak (X), gold had rallied far, far above its MA. At this point past precedent indicated that gold was due for a correction. The question -- how big a correction, and would gold come down to touch its MA or even drop temporarily below it?

I warned repeatedly that we could expect violent, erratic, and yes, scary action in this early phase of the gold move. We've certainly got wild action -- in spades.

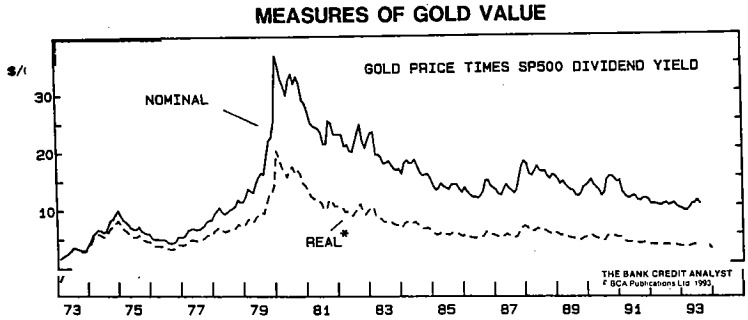
Now back to the original question. Was the rise from the March 326 low just another deceptive but impressive upside explosion --- or was it the initial impulse signaling a major bull market? My opinion -- the latter; I think it was the send-off to a bull market.

With the exception of the rise in 1990, the moving average for gold has been heading down ever since early 1988. But here in 1993, for the first time, the MA turned up and simultaneously the long declining trendline from the 1980 peak (see Letter 1121) was reversed to the upside. This is different action, and I believe, meaningful action.

Here's another thought -- is gold fundamentally cheap or expensive? The latest *Bank Credit Analyst* has something to say about this. They note that "the best approach to valuing gold is to examine its purchasing power in terms of other assets or goods."

So *BCA* compares gold in terms of the dollar amount of S&P dividends that one can purchase with a single ounce of gold. The accompanying chart shows the gold price multiplied by the dividend yield on the S&P 500. The current yield on the S&P 500 is 2.72%. Multiply that by the price of gold and we get 9.38 or considerably less than $10. At gold's peak price in 1980 the ratio was above $35. The lower dotted line shows this same ratio in real (inflation adjusted) terms.

MEASURES OF GOLD VALUE



The Bank Credit Analyst concludes, "In real terms, the dividends foregone by holding gold are no higher now than in 1973. That point preceded a major bull market in gold and a bear market in stocks. In sum, gold appears cheap in relation to the stock market." (Chart courtesy of the *Bank Credit Analyst* -- 514-398-0653). Note: I made a mistake in the last Letter concerning gold options. I bought the February, not April, 420 options for $3.30. So far, it's been a loser.

FUNDAMENTALS: *"Where else can you walk out of your mortgaged home, step into a time-payment car, and drive down a bonded highway on credit card gas to charge something at your favorite store?"* I dunno, but that's the question Tom Anderson asks in his *Straight Talk* publication.

I guess I'm tired of saying this, and subscribers must be tired of hearing it -- but this nation, and I'm talking about the US, has two choices. It must "inflate or die" (and by die I mean deflation and depression).

The US passed the point of no return years ago as far as paying off the national debt is concerned. Under Clinton's first term, the national debt will increase by another trillion dollars, pushing the total well above five trillion. Then there's corporate and municipal and individual debt, which takes the debt total in the US to above 15 trillion dollars.

Forget paying off that 15 trillion. It's never going to be paid off, but you absolutely MUST support that debt, finance it, which means paying the interest on it. If you can't pay the interest on your debt, well, you're talking bankruptcy. In other words, with this much debt outstanding, there's no way the US can take deflation. If the US sinks into net deflation, then debt will overwhelm the markets and we'll face the damnedest depression you've ever seen.

The way out (and the Fed knows this) is the true-blue American way -- inflation or paying off debts with CHEAPER DOLLARS. It's got to happen. The only questions are how low the dollar will go, and the timing of the loss in purchasing power. As I've been saying in Letter after Letter, we're still in the early phases of a switch from financial assets to real assets. The early gold buyers, maybe even the early real estate buyers like George Soros, see that. But in general the public and the fund managers don't see it, and thus the public continues to pour a billion dollars a day into financial assets -- stock and bond mutual funds -- rather than gold and real estate and tangible assets.

How long will the transition phase take? How long will it take before the stock and bond markets top out and how long before the infant bull market in gold starts to attract the attention of the funds and the big investors? I don't know the answer to that one. I would guess less than a year. It's a question of timing, and the exact timing is impossible. I believe the transition, the very early part of the transition has already started, and by mid-1994 we'll know it's happening. In the meantime, as Charles Dow put it, we'll "need the patience of 10 men."

By the way, almost secretly (no media coverage), Congress has raised the legal ceiling on the US national debt to $4.9 trillion.

LATE NOTES: World stock markets continue to inflate, even as the dollar sinks. What we're seeing is the "American-ization" of world markets, as US money pours into the various markets of the world (looking for bargains, of course). FOREX traders, seasoned investors, sophisticated traders and speculators are all watching two areas, the dollar and US bonds. The bonds have gone parabolic, always a dangerous situation, and the dollar has gone "thud." My opinion -- the US could sink back into recession by the first quarter of next year. The bearishness regarding gold is now so thick you could cut it. Contrary opinion time?

NEXT MAILING: Sept. 29, 1993